2023 Federal Economic Statement

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Highlights

- A stronger hand-off has given the government greater fiscal space in the near-term, but a downgrade to 2024 growth prospects, some new spending promises since Budget 2023 and higher interest rates lead to a net deterioration in the budget balance, especially in outlying years.
- There were virtually no surprises in terms of initiatives. A total of $15.9 billion in new spending measures were announced, including $6.2 billion on improving housing supply and $8.5 billion on industrial supports for EV battery supply chain and other clean economy investments announced since Budget 2023.
- Despite the upgrade to the medium-term deficit profile, the government's accumulated deficit is still expected to follow a downward trajectory over the next 5 years. In addition to this objective, the government pledged to run a deficit no larger than 1% of GDP in future years.

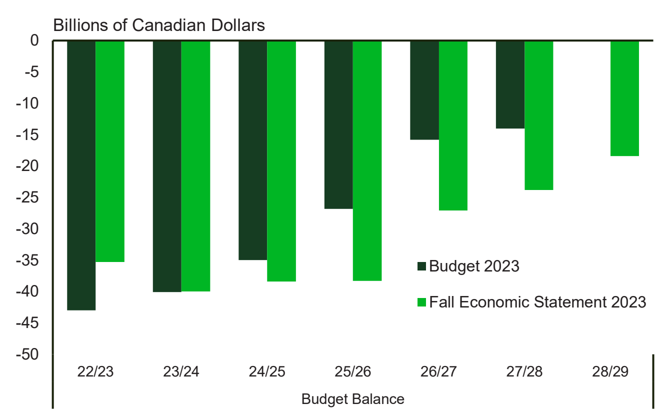
Deficits in a Time of Weakening Economic Growth

In its updated fiscal outlook, the government is benefitting from a stronger starting point, thanks to an $8 billion undershoot of last year's budget estimate in fiscal 2022-23. However, this improvement gives way to some deterioration in budget balances, especially in the outlying years of the forecast. The government's expected shortfall this year and next has been held virtually steady relative to the spring budget, before recording a cumulative $20 billion erosion between fiscal 2024-25 and 2027-28. (Chart 1). Notwithstanding this, the government deficit as a per cent of GDP declines through the forecast to roughly 0.5%, in line with Budget 2023.

The Minister today announced a new fiscal anchor in addition to its long-standing commitment to keep its debt burden trending lower. The fiscal anchor is now for the deficit to GDP ratio to be no greater than 1%.

Changes to the government's economic projections explain part of the revised fiscal outlook. While the nominal GDP growth forecast has been upgraded for 2023 based on private sector assumptions (from 0.8% to 2.0%), a cleaver has been taken to growth prospects in 2024 (from 3.6% to 2.4%). This latter adjustment is expected to weigh on revenue gains over the next year. These numbers are in line with TD Economics. However, the 4.3% average nominal growth forecast is somewhat more optimistic than ours.

Chart 1: Widening Deficits Over the Forecast Horizon



Note: 28/29 projection not included in Budget 2023.
Source: Department of Finance, Government of Canada, TD Economics.

Table 1: Fall Economic Statement 2023 - Summary Billions of Dollars, Unless Otherwise Stated							
Fiscal Year	**22-23**	**23-24**	**24-25**	**25-26**	**26-27**	**27-28**	**28-29**
Budgetary Revenues	**447.8**	**456.2**	**483.4**	**502.4**	**527.4**	**551.0**	**573.8**
Program Expenses	438.6	442.2	466.8	484.8	499.4	515.5	534.1
Public Debt Charges	35.0	46.5	52.4	53.3	55.1	58.4	60.7
Total Expenditures	**473.5**	**488.7**	**519.2**	**538.1**	**554.5**	**573.9**	**594.8**
Budgetary Balance Before Net Actuarial Losses	-25.7	-32.5	-35.8	-35.7	-27.1	-22.8	-20.9
Budget Balance	**-35.3**	**-40.0**	**-38.4**	**-38.3**	**-27.1**	**-23.8**	**-18.4**
Per Cent of GDP							
Budgetary Revenues	15.9	15.9	16.5	16.4	16.5	16.5	16.5
Program Expenses	15.6	15.4	15.9	15.8	15.6	15.4	15.3
Public Debt Charges	1.2	1.6	1.8	1.7	1.7	1.7	1.7
Budget Balance	-1.3	-1.4	-1.3	-1.2	-0.8	-0.7	-0.5
Federal Debt	41.7	42.4	42.7	42.2	41.2	40.2	39.1
Budget Balance - Downside Scenario	**-35.3**	**-45.1**	**-51.2**	**-50.6**	**-36.4**	**-29.7**	**-24.2**
Per Cent of GDP - Downside Scenario							
Budget Balance	-1.3	-1.6	-1.8	-1.7	-1.1	-0.9	-0.7
Federal Debt	41.7	42.7	44.2	44.0	42.9	41.8	40.8

Note: Totals may not add due to rounding.
Source: Department of Finance, Government of Canada, TD Economics.

New policy measures are relatively small, mainly on the spending side of the equation and back-end loaded to beyond fiscal 2024-25. New spending on boosting housing supply and details on previously announced clean economy supports were a focus in today's FES. These programs amount to $15.9 billion in new spending over 2023-29 and add to the already announced policy actions related to EV subsidies and purpose-built rental housing. Much of this spending has been deferred in the budget until after fiscal 2024-25.

Despite the lower price tag on new commitments than many observers likely expected, program spending as a percent of GDP is still projected to hold up at above 15% over the forecast horizon, compared to around 14% before the pandemic.

Interest costs are slated to be another significant headwind on the government's medium-term fiscal plan. The government has revised upwards its assumption on the BoC policy rate (by 100 bps this year and assumes the rate remains 25 bps higher on average over the next four years). As such, debt service charges are expected to rise to just under $60 billion by fiscal 2027-28 compared to the spring budget estimate of $50 billion. As a share of revenue, interest costs are projected to rise from around 1% at the low point during the pandemic to 1.8%.

There is a lot of risk around these projections. The government's economic forecast reflects that of a soft landing where the economy avoids a recession. While this base case scenario makes sense given the economy's resilience over the last two years, should the economy contract in line with the government's downside scenario, new borrowing requirements would increase dramatically. Deficits as a percent of GDP would then reach a peak of 1.8% in 2024-25, before falling to 0.7% in 2028-29.

Summary of Significant New Measures

Canada's Housing Action Plan: There were a number of actions to jumpstart the much needed development of Canada's housing supply, especially in order to keep up with the country's population surge. The big one is the government providing $15 billion in new loan funding to directly support the building of more than 30,000 new homes.

The Affordable Housing Fund, will provide an additional $1 billion over three years (starting 2025-26) to support non-profit/co-op/public housing build 7,000 new homes by 2028. The FES also includes the government tying access to infrastructure funds to provinces' efforts to increase housing supply, removing the GST from new co-op rental housing, leveraging the Canada Infrastructure Bank to support housing, and cracking down on short-term rentals that are keeping supply off the market. This will amount to $6.2 billion in total spending.

Supporting a Strong Middle Class: These measures included efforts to stabilize prices in Canada by cracking down on corporate predatory pricing, addressing high grocery prices, cutting taxes on mental health, and temporarily pausing the Federal pollution price on heating oil. While these measures only amount to $168 million in spending, they could go a long way to help Canadians' quality of life, especially if they can reduce inflationary pressures.

Building an Economy That Works for All Canadians: This includes measures to support the growth of the clean economy sector. The standout item was the detail about the net fiscal impact of the industrial supports for clean technology investments that have been announced since Budget 2023. These deals include the Stellantis-LGES EV battery plant and the Volkswagen EV battery cell plant, which will get production subsidies of up to $15 billion and $13 billion, respectively, from the federal and Ontario governments. The FES estimates that the industrial supports will cost the federal government $8.5 billion over 2023-24 to 2028-29. Additionally, the government has committed $853 million from 2023-24 to 2028-29 to expand eligibility for the 30% clean technology investment tax credit and the 15% clean electricity investment tax credit to include systems that generate electricity and heat from waste biomass. The total spending for these measures is $9.4 billion over 2023-24 to 2028-29.

Bottom Line

Enjoying an improved hand-off into the current fiscal year, the federal government took the opportunity to use some of that wiggle room to deliver on targeted priorities in this update. Still, with a looming slowdown and the growing weight of higher interest rates, the government has effectively abandoned all hope of running a surplus at any point over the forecast horizon. Luckily, the government is acting from a position of strength, as it has maintained the best net debt-to-GDP ratio of all G7 nations. While there was some hope that the government would build on this advantage, new spending – even if modest compared to recent post-pandemic budgets and fiscal updates -- means somewhat less dry powder to combat a potential economic slowdown.

There will be a lot of questions on just 'how inflationary' this update will be given Bank of Canada (BoC) Governor Macklem's recent comments on how the federal and provincial governments are adding to the country's inflation problem. Clearly, rising spending in the government's plan doesn't change that narrative substantially. Still, its decision to largely stay its hand on any new spending in the current year and/or delay initiatives to later in the fiscal horizon indicates that the government has got the memo.

The Canadian economy has slowed significantly since the release of Budget 2023 and this trend looks set to continue as elevated household debt limits consumer spending. We anticipate this will result in job losses in early 2024, with the economy flirting with recession. From this standpoint, there is risk that the government's finances could be in for another hit. And while the government has focused on the expectation that the deficit-to-GDP ratio will decline over the forecast horizon, should the economy falter more than expected, the government's fiscal position could be tested.